State Notes

TOPICS OF LEGISLATIVE INTEREST

November/December 2006

Principal Residence Exemption Compliance Program

By Stephanie Yu, Fiscal Analyst

The principal residence exemption was created by Public Act (PA) 237 of 1994.[1] The exemption was part of a larger school finance reform package passed in 1994 to address accelerating property taxes and an increasing discrepancy in per-pupil spending across communities. In order to ease high property taxes for homeowners, the package created the homestead exemption and capped the rate at which assessed property values could increase. It may be claimed by a taxpayer on one property, and exempts that taxpayer from having to pay the 18.0-mill local school property tax. Owners of multiple residences may claim only one exemption on the domicile that is their principal residence. Due to the nature of the exemption, it is necessary to compare data across jurisdictions to identify taxpayers who, knowingly or unknowingly, claim the exemption improperly. Efforts to accomplish this are discussed below.

History

Since the exemption was introduced in 1994, the Department of Treasury has tracked claimed exemptions through a database. Local units receive affidavits filed by the homeowners claiming the exemptions, and the affidavits are passed on to the Department. While the Department does maintain a central database, that system is inadequate. Information is often incomplete, missing taxpayer or property information, or the affidavits might contain more than one property. Additionally, rescissions might not always be filed when individuals sell their residence, which results in the attachment of multiple exemptions to one property. Another major problem with the State database is that its match function is relatively unsophisticated; for example, it is unable to account for minor differences in information, such as taxpayers' middle initials, or changes to the prefixes or suffixes of parcel numbers, or the division of the parcels themselves or other changes to them. As a result, rescissions that are filed may not invalidate the original exemptions.

Public Acts 105 and 114 of 2003 amended the principal residence exemption compliance program, allowing counties to audit homestead exemptions and obligating the State to perform audits in any counties that elected not to perform them. In cases in which the exemption is erroneously claimed, the county or local government may collect taxes due as well as interest and penalties. In 2003, the Department of Treasury estimated that it would collect total revenue, including taxes, penalties and interest, of $61.0 million in fiscal year (FY) 2003-04, $32.3 million in FY 2004-05, and $21.5 million each year after FY 2004-05. Revenue from the taxes goes to local school districts, reducing School Aid Fund expenditures, while interest and penalties are shared among county, local, and State governments. The unit performing the audit receives the majority of funds collected in interest and penalties. Sixty-one of the State's 83 counties opted to perform their own audits, while the remaining 22 chose to have the Department perform them. For the counties that

[1] Originally called the "homestead" exemption, it is now referred to as the "principal residence" exemption, as a result of legislation enacted in 2003 to avoid confusion with the homestead credit against property taxes.

chose to perform the audits themselves, Treasury provided a list from its database, identifying potentially problematic exemptions.

In order to fund the State's costs related to counties that chose not to perform the audits, PA 161 of 2003, the general government appropriations act for FY 2003-04, included the following language:

> Sec. 925. (1) In addition to the funds appropriated in part 1, the department of treasury may receive and expend homestead property tax exemption audit fund revenue for administration of homestead property tax exemption audits consistent with the provisions of Enrolled Senate Bill No. 520 of the 92nd Legislature.
>
> (2) The department of treasury shall submit a report for the immediately preceding fiscal year to the state budget director and the senate and house fiscal agencies not later than December 31, stating the amount of revenue appropriated for homestead property tax exemption audits under subsection (1).

The language was included again in PA 327 of 2004, the general government appropriations act for FY 2004-05. The Legislature did not appropriate funds for the program in either FY 2003-04 or FY 2004-05.

To comply with this program, the Department engaged in two separate functions: issuing lists of leads to those counties that opted to perform their own audits, and auditing the remaining counties. The leads lists were culled from problematic exemptions, such as property with more than one exemption listed, or exemptions for which the billing address did not match the address of the principal residence. When the counties received the lists, they then could choose to take further action. The Department has no ability to track what the counties subsequently do. For those counties that chose not to perform their own audits, the Department created similar lists, compared income tax rolls with the addresses in the database, and issued approximately 69,000 letters to taxpayers, requesting further proof of their eligibility for the exemption. The Department received many complaints about this method, but ultimately issued 3,000 denials of these exemptions. The local units then needed to update their tax rolls to reflect the changes, but the Department has no means to enforce this.

In FY 2003-04 and 2004-05, legislative transfers were required to cover State costs for this program in the amounts of $600,000 and $500,000, respectively. It is estimated that the State received interest payments totaling $50,000 in FY 2003-04 and $80,000 in FY 2004-05.

In FY 2005-06, the principal residence exemption compliance program was rolled into the line item for the revenue enhancement program (which was appropriated $6,590,000), and $750,000 was earmarked for the audits. The language in PA 146 of 2005 reads as follows:

> Sec. 947. (3) The $750,000.00 balance of the $6,590,000.00 shall be used for the principal residence exemption compliance program. By November 1, 2005, the department of treasury shall submit a detailed spending plan regarding expenditure of the $750,000.00. The plan shall include improvements to the current program administered by the department pursuant to PA 105 of 2003, and projected collections related to program improvements. The department shall also submit quarterly progress reports that detail the number of audits, number of exemptions denied, and the distribution of revenue received. The legislative auditor general shall complete a performance audit of the principal residence exemption compliance program prior to April 1, 2006. Revenue generated to the state from principal residence audits conducted under the principal residence exemption compliance program shall be used to reimburse the state general fund for the $750,000.00 appropriation prior to any other allocation.

As of the end of January 2006, the Department had submitted a spending plan for the Principal Residence Exemption Compliance Program indicating that $500,000 would be spent on a private contract to conduct the audits, $200,000 on administration, and $50,000 on information technology. Pursuant to that plan, the Department issued a Request for Proposal in January of 2006 to select a vendor for the program. However, by the February 15, 2006, deadline, the Request for Proposal generated only two responses, neither of which met the criteria established by the Department of Treasury. The Auditor General's office has indicated that it will not be able to perform the scheduled audit of the program as it is not yet in place. The recommended budget for FY 2006-07 includes a reduction of $250,000 for the Principal Residence Exemption Compliance Program, leaving $500,000 in the appropriation. The Department re-bid the contract in the summer of 2006 and accepted a bid from Tax Management Associates (TMA) to audit the 30 counties that will not perform their own audits in 2006 and 2007. As of December 2006, TMA had begun gathering data and expected to begin audit work in January 2007.

Revenue Generation

As mentioned above, local school districts retain any taxes collected, while the interest and penalties are distributed among the county, local, and State governments. Counties were given the choice to conduct their own audits or to allow the State to do the audits. If the counties perform the audits, they receive a larger percentage of the interest collected, whereas if the State has the responsibility, it retains a larger portion of that interest. The majority of counties chose to handle the audits themselves, some with help from the State. Because the counties are responsible for distributing any revenue generated, it is difficult for the State to track what has been collected. Revenue for local school districts reduces School Aid Fund spending, but cannot be traced to the program. Additionally, amendments to the statute allow counties to grant retroactive exemptions, which may be offsetting a portion of the revenue generated.

Since the State was unable to establish a contract to perform these audits until the end of the FY 2005-06 (September 15, 2006), it is unknown what portion of the appropriated $750,000 has been spent. The Department has indicated that it is unlikely all of these funds would be spent during FY 2005-06.

Statewide Database

During Senate budget hearings on the FY 2006-07 budget bill, the Appropriations Subcommittee on General Government heard testimony from a variety of local officials on the Principal Residence Exemption Compliance Program. The testimony varied greatly regarding the revenue potential of the program. A representative from St. Joseph County indicated that in her preliminary analysis, there were many improper exemptions. The treasurer from Ingham County testified that the number of illegal exemptions in that county was relatively low and their denial probably would not generate significant tax revenue. While the testimony regarding the potential for revenue varied, the local officials agreed that a statewide database would make the enforcement of the program much simpler, and that the information that the Department of Treasury was providing was outdated. Following this testimony and discussions with the Department, the Legislature included the following language in PA 345 of 2006, the FY 2006-07 appropriation act for general government:

> Sec. 947. (3) The $500,000.00 balance of the $5,856,800.00 shall be used for the principal residence exemption compliance program. Along with other program costs, expenditures shall include the development of a statewide web-based database created for the purpose of enforcing the principal residence exemption compliance program. The department shall submit quarterly progress reports that include the number of exemptions denied and the revenue received under this program. The legislative auditor general shall complete a performance audit of the principal residence exemption compliance program prior to April 1, 2007. Revenue generated to the state from the principal residence exemption compliance program shall be used to reimburse the state general fund for the $500,000.00 appropriation prior to any other allocation. Additional funds from the revenue enhancement program and carryforward appropriations may be used to support costs in excess of $500,000.00.

Language added to the Act also designates revenue enhancement funds as a work project, allowing unspent funds to be carried forward and used to support the program in subsequent years. It is expected that the database will require considerable time to create, and ongoing resources to maintain. Any remaining funds from the $750,000 appropriated in FY 2005-06 also may be used for the database and the TMA contract.

State Notes

TOPICS OF LEGISLATIVE INTEREST

November/December 2006

Michigan TANF/Maintenance of Effort Requirement
By Constance A. Cole, Fiscal Analyst

Introduction

Michigan revenue is projected to come in at a level below the fiscal year (FY) 2006-07 enacted appropriations. If this projection is accurate, the situation will necessitate either spending cuts or revenue enhancements (or some combination of both). Often, in budget crises, various programs are mentioned for places to "cut the budget". Many programs funded with State dollars, however, are counted as "maintenance of effort" (MOE) funding, required to receive the Federal Temporary Assistance for Needy Families (TANF) block grant. The State's access to TANF funding for human services requires the State to maintain expenditures of State funds at 75.0% of the historically spent funds for low-income programs. This article describes the eligible programs the State uses to meet the Federal block grant requirements. In the event that program reductions are necessary to balance the budget, an awareness of what programs make up this delicate balance will assist with important budget decisions when State leaders consider adjustments in existing programs.

Background

The Temporary Assistance for Needy Families Program is a Federal block grant to states established as part of welfare reform in the United States. The TANF Program, created by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Public Law 104-193 of 1996 (PRWORA), was extended 12 times by Congress from October 2002 to September 2006 and reauthorized for an additional five years, through FY 2009-10, by the Deficit Reduction Act of 2005 (DRA). The statutory changes did not modify the four purposes of the TANF Program. Under the Federal law, states are given flexibility in their effort to help families move from welfare to work. States are allowed to craft programs that fit under the four Federal purposes, funded with Federal, state, and other sources, which best aid their citizens to become independent of government assistance.[1]

The required spending of state funds, the maintenance of effort, must meet one or more of the four purposes outlined in the PRWORA. The expenditures must be maintained at 80.0% of a state's FY 1994-95 expenditures (the spending baseline) for low-income programs for families or at 75.0% if a state meets the Federal work participation rate requirements for single- and two-parent families.[2] States are required annually to report MOE expenditures related to family data (for example, caseload information such as the number of family members, Social Security numbers, and receipt of other benefits) and costs of state programs providing assistance (just as states are required to report for TANF-funded programs) in order to qualify for a caseload reduction credit or receive high performance bonus funds. The Federal rules allow states to assist eligible families through the use of state-funded programs (not supported with TANF funds) that are not subject to TANF requirements, such as work participation and time limits on the receipt of Federal assistance.

[1] See Program Purposes, in Senate Fiscal Agency Issue Paper "Temporary Assistance for Needy Families (TANF): An Overview of the Michigan Program and the Expenditures of Federal and State Resources", January 2002, Page 5.

[2] See Program Eligibility in Senate Fiscal Agency Issue Paper "Temporary Assistance for Needy Families (TANF): An Overview of the Michigan Program and the Expenditures of Federal and State Resources", January 2002, Page 6.

The use of these programs, referred to as Separate State Programs (SSPs), is attractive to states because they are not subject to TANF rules. In Michigan, currently all SSPs claimed for MOE are considered nonassistance because they do not provide cash assistance to families under the SSPs.

There are four penalties assessed for failure to meet the MOE requirement. The first penalty is a reduction in the TANF grant equal to the amount by which the state fails to meet the requirement. The second penalty is an adjustment in the MOE requirement. For example, if in a given year, a state were short in its MOE spending, the following year the state would have to make up that shortfall, and, if the state had been eligible for the 75.0% of 1994-95 expenditures funding level, it would face the higher 80.0% level. Third, a penalty is assessed equal to Federal contingency funds received but not remitted by the state for a fiscal year. The level and provision of contingency funds has fluctuated over the years depending on Congressional approval. A fourth penalty is equal to the state's Welfare-to-Work formula grant during a year in which the state receives the grant payment.[3]

In meeting the MOE, if Michigan were to begin claiming SSPs that do provide cash assistance benefits, then the State could face a further penalty if it failed to meet additional reporting requirements. Under the DRA, each state that claims MOE expenditures for SSPs that provide cash assistance benefits must collect data on a monthly basis and file on a quarterly basis; failing to do so would result in a reduction in the TANF block grant of 4.0%, which would be approximately $31.0 million in Michigan's case, unless the State were to submit a compliance plan and complete the prescribed corrective action plan.

Michigan has met an adjusted level of the work standard for the past 10 years and therefore, since the inception of the Federal block grant, the State's required MOE spending has been at the 75.0% level, which is $468,518,400. A portion of the State expenditures has been counted from the Departments of Human Services (DHS), Labor and Economic Growth (DLEG), Community Health (DCH), Education (DOE), and Transportation.

Description of Eligible Programs

The State of Michigan has used a number of programs' expenditures since FY 1996-97 to meet the required MOE spending. Some State program expenditures have been counted each year, while others may have been counted only one or more years. Following are descriptions of programs included in the Michigan FY 2004-05 Annual Report on State Maintenance-of-Effort Programs, the most recent available report, that comprise State spending counted toward the MOE requirement.

1. <u>All Students Achieve Program - Parent Involvement in Education</u>. This program, commonly known as the "School Readiness Program", with funds appropriated in the DOE, provides support for families from birth to enrollment in kindergarten through a community-school-home partnership, which is designed to improve school readiness, reduce the need

[3] The last year Michigan received a Welfare-to-Work formula grant payment was in FY 1998-99. The Federal Welfare-to-Work Grant was a five-year program that expired in FY 2002-03. Therefore, there is some question regarding how this penalty would be calculated.

for special education services, and foster the maintenance of stable families. Program participants receive encouragement through positive parenting skills training, enhancement of parent-child interaction, and access to needed community services; the program also provides parents with information on child development. The FY 2004-05 Report included $4.1 million in All Students Achieve Program – Parent Involvement State expenditures. This is a nonassistance separate State program.

2. At-Risk – Section 31a. This program, appropriated in the DOE, provides direct noninstructional services including, but not limited to, medical and counseling services for at-risk students, behavioral management training, home/school liaison programs, and teen parenting programs. The FY 2004-05 Report included $41.7 million in At-Risk – Section 31a State expenditures. This is a nonassistance separate State program.

3. Child Care. The Child Care and Development Fund supports services and payments necessary to promote self sufficiency. The FY 2004-05 Report included $188.1 million in Child Care State expenditures. This program is subject to TANF requirements.

4. Child Support Participation. This program encourages cooperation in the collection of child support by giving parents an additional payment in an amount up to the first $50 of current-month child support collected on behalf of recipients of State cash assistance. The FY 2004-05 Report included $4.9 million in Child Support Participation State expenditures. This program is subject to TANF requirements.

5. Employment and Training Support Services. The support services for employment and employment-related activities include but are not limited to the following: transportation, mentoring, auto repair, and money management. The program also provides employment services to noncustodial parents who are unemployed or underemployed to enable them to meet their responsibilities in the support of their children. The FY 2004-05 Report included $699,300 in Employment and Training Support Services State expenditures. This program is subject to TANF requirements.

6. Family Independence Program (FIP). The State cash assistance program is administered by the DHS through its local (county) offices to help maintain and strengthen family life for children and the parents or other caretakers with whom they are living, and to help the family achieve the maximum possible self support and personal independence. The funds for case management services provided to eligible clients and the administration, including systems used to administer the program statewide, also are counted. The FY 2004-05 Report included $236.4 million in FIP (including administration, systems, and case management) State expenditures. These programs and services are subject to TANF requirements.

7. Great Parents Great Start Program. The program's purpose is to improve school readiness and foster the maintenance of stable families by encouraging positive parenting skills. This is a separate State program, which is funded with Federal Child Care and Development Fund and State dollars in the DHS. The FY 2004-05 Report included $1.9 million in Great Parents Great Start State expenditures. This is a nonassistance separate State program.

8. Low Income and Energy Efficiency Fund (LIEEF). The LIEEF is a State fund that includes payments from the Detroit Edison and Consumers Energy utility companies set by the Public Service Commission pursuant to 2004 and 2005 court decisions in a rate case. The funds are appropriated in DLEG. As part of an interagency agreement between DLEG and the DHS, a portion of the funds is used to supplement existing energy assistance, allowing an increase in assistance to low-income clients. Services provided include shut-off and other protection for low-income customers and the promotion of energy efficiency. The FY 2004-05 Report included $25.0 million in LIEEF State expenditures. This program is subject to TANF requirements.

9. State Emergency Services. These programs provide emergency assistance to families to help them obtain safe and affordable shelter and other essentials when they face an emergency due to factors beyond their control. The FY 2004-05 Report included $1.2 million in State Emergency Services expenditures. These programs are subject to TANF requirements.

Figure 1 illustrates the State's MOE claims by the department. In addition to the FY 2004-05 Report programs, there are other programs whose expenditures counted toward the MOE requirement in previous years. Below are examples of programs previously counted toward MOE but not needed in FY 2004-05.

Adoption Support Subsidy. The program funds, appropriated in the DCH, provide support payments to families of adoptive children with special needs. The payments are to facilitate the adoption of special-needs children by removing financial barriers for the families and allowing the children to be cared for in an adoptive family home.

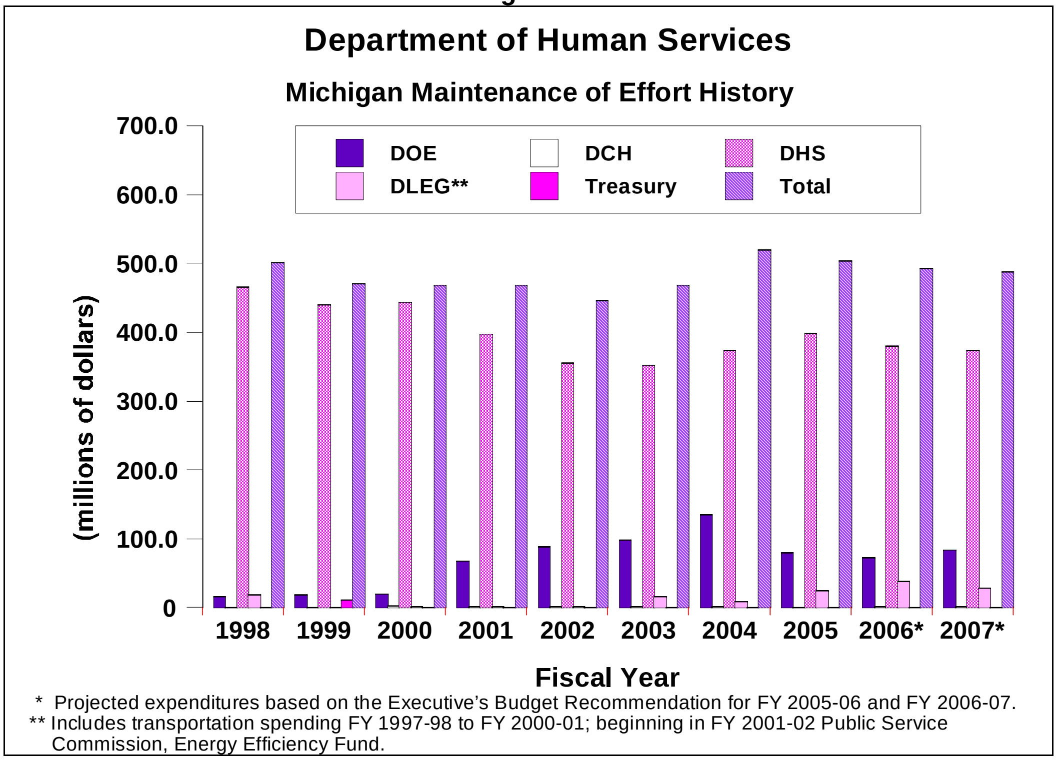
Homestead Property Tax Rebate. A family receives this refundable tax credit even if it exceeds what the family owes in taxes. The credit benefits low-income citizens who must pay large portions of their income on property taxes or rent. The State funds appropriated for the credit in the Michigan Department of Treasury, which were paid to low-income families with children, were claimed toward the MOE requirement in FY 1998-99.[4]

Transitional Medical Assistance. The funds, appropriated in the DCH, provide a subsidy for the cost of premiums that are shared by families and the State and were countable under TANF purpose #2, which is to end the dependence of needy parents on government benefits through the promotion of job preparation, work, and marriage.

Zero to Three: Secondary Prevention. The program funds, appropriated in the DCH and the DOE, are spent for public and mental health consultation services to eligible child care providers who serve children 0 to 5 years of age, with a special emphasis on children ages 0 to 3. The service provision must have a positive impact on the emotional development of the State's children.

[4] See Other Issues in Senate Fiscal Agency Issue Paper "Temporary Assistance for Needy Families (TANF): An Overview of the Michigan Program and the Expenditures of Federal and State Resources", January 2002, Page 9.

Figure 1



New Federal Rules' Impact on MOE

The DRA made some changes to the TANF and MOE programs' rules. The MOE reporting requirements for cash assistance SSPs – MOE claims, as mentioned earlier, have been modified from quarterly reports to qualify for the caseload reduction credit or receive high-performance bonus funds, to mandatory quarterly reports for all states that make cash assistance SSPs - MOE claims. Another change made in the rules is a revision to the definition of work-eligible individual. This change clarifies program eligibility identification for all TANF- and MOE-related programs; therefore, there is no impact on state procedures. Finally, the DRA includes a new provision that allows states to make MOE claims for all qualified pro-family expenditures for nonassistance benefits and services provided to or on behalf of an individual or family if expenditures accomplish TANF purpose #3 (to prevent and reduce out-of-wedlock births) or purpose #4 (to encourage the formation and maintenance of healthy two-parent married families).

Conclusion

The states' flexibility in MOE-required state spending is important to Michigan for it allows the State to make claims for program spending that meets the State's TANF program implementation needs. Michigan has been able to use a variety of different programs, both TANF and separate-state, that will continue to assist citizens to become self-sufficient and independent from State assistance.

State Notes

TOPICS OF LEGISLATIVE INTEREST

November/December 2006

Michigan's Cable Franchising System
By Julie Cassidy, Legislative Analyst

Introduction

In December 2006, Governor Jennifer Granholm signed into law House Bill 6456, creating the "Uniform Video Services Local Franchise Act". The Act revises the system for the provision of cable television services, in response to concerns that in many communities, residents do not have a choice of cable providers, and have experienced steadily increasing cable rates over the last several decades. Until now, a cable provider had to negotiate a separate franchise agreement with each municipality (i.e., franchising entity) in which it desired to offer service. The franchise agreement typically prescribed the fee the provider would pay to the local unit for right-of-way use; a minimum number of households to which the provider had to provide service (build-out provisions); any public, education, and government (PEG) channels that had to be provided; and enforcement procedures for the local unit. Under the Act, which took effect on January 1, 2007, the Public Service Commission (PSC) must design a uniform franchise agreement to be used statewide. A local unit may not require a cable provider to obtain any other franchise, and may not assess any fee or impose any franchise requirement other than as allowed under the Act.

This article contains an overview of the legislation and the debate surrounding the cable franchising system. The article also touches on the unresolved issue of net neutrality. (For a detailed description of the Act and an analysis of its fiscal impact, please see the Senate Fiscal Agency's Enrolled Summary of House Bill 6456, available at www.legislature.michigan.gov.)

Uniform Video Services Local Franchise Act

Uniform Franchise. The Act prohibits a person from providing video services in any local unit of government without first obtaining a uniform video service local franchise, as established by the PSC, except as otherwise provided. The uniform franchise is to be issued by the local unit. It will be effective for 10 years, and may be renewed in 10-year increments. As noted above, a franchising entity may not require a video service provider to obtain any other franchise, and may not assess any fee or charge or impose any franchise requirement other than that allowed under the Act, as a condition to obtaining or holding a franchise. The Act specifies that any provisions of a franchise agreement existing on the Act's effective date that are inconsistent with or in addition to the provisions of the uniform agreement are unreasonable and unenforceable.

An incumbent video provider (a cable operator providing services on the Act's effective date) may continue to provide video services to the franchising entity by electing to do one of the following:

-- Terminate the existing franchise agreement before its expiration date and enter into a new franchise under a uniform agreement.
-- Continue under the existing agreement, amended to include only those provisions required under a uniform local franchise.

-- Continue to operate under the terms of an expired franchise until a uniform agreement takes effect.

If a franchising entity authorizes two or more providers, the franchising entity may not enforce any term, condition, or requirement of any franchise agreement that is more burdensome than the terms, conditions, or requirements contained in another franchise agreement.

Voluntary Franchise Agreement. The Act states that it does not prohibit a local unit of government and a provider from entering into a voluntary franchise agreement that contains terms and conditions different than those required under the Act, including a reduction in the franchise fee in return for the provider's making available to the franchising entity services, equipment, capabilities, or other valuable consideration.

PEG Channels. A video service provider must designate a sufficient amount of capacity on its network to provide for the same number of PEG access channels that were in actual use on the incumbent video provider system on the Act's effective date. Any PEG channel that the franchising entity does not use for at least eight hours per day for three consecutive months may no longer be made available to the franchising entity and may be programmed at the provider's discretion. When the franchising entity can certify a schedule for at least eight hours of daily programming for three consecutive months, the provider must restore the previously reallocated channel.

Fees. The Act requires a video service provider to calculate and pay an annual video service provider fee to the franchising entity. If there is an existing franchise agreement, the fee must be an amount equal to the percentage of gross revenue paid to the franchising entity by the incumbent provider with the most subscribers in the franchising entity. At the expiration of an existing agreement, or, if there is no existing agreement, the fee must be an amount equal to the percentage of gross revenue as established by the franchising entity, up to 5%.

Additionally, a provider must pay to the franchising entity as support for the cost of PEG access facilities and services an annual fee equal to one of the following:

-- If there is an existing franchise agreement, the fee paid to the franchising entity by the incumbent provider with the most cable service subscribers in the franchising entity under that agreement.
-- Upon expiration of the existing agreement, the amount described above, not to exceed 2% of gross revenue.
-- If there is no existing agreement, a percentage of gross revenue as established by the franchising entity not to exceed 2%, to be determined by a community need assessment.

The required fees must apply to all providers.

Video Service Provider Fee Credit. A provider is entitled to a credit applied toward the video service provider fees for all funds allocated to the franchising entity from annual maintenance fees paid by the provider for use of public rights-of-way, minus any property tax credit allowed under the Metropolitan Extension Telecommunication Rights-of-Way Oversight (METRO) Act. The credit must be calculated by multiplying the number of linear feet the provider occupies in the public rights-of-way by the lesser of five cents or the amount assessed under the METRO Act. A provider is not eligible for this credit unless it has taken all property tax credits allowed under the METRO Act.

PSC Costs. Within 30 days after the enactment of any appropriation to the PSC, the Commission must ascertain the amount of the appropriation attributable to its actual costs in exercising its duties under the new Act, and that amount must be assessed against each provider doing business in the State, based on its share of the total number of video service subscribers in the State. The total assessment may not exceed $1.0 million. This requirement does not apply after December 31, 2009.

Right-of-Way Access. A franchising entity must allow a provider to install, construct, and maintain a video service or communications network within a public right-of-way, and to allow the provider open, comparable, nondiscriminatory, and competitively neutral access to the right-of-way. A franchising entity may not discriminate against a provider for the authorization or placement of a video service or communications network in public rights-of-way; access to a building owned by a governmental entity; or a municipal utility pole attachment.

Build-Out Provisions. The Act prohibits a provider from denying access to service to any group of potential residential subscribers due to the race or income of the residents in the local area. It is a defense to an alleged violation of the prohibition that the provider has met either of the following conditions:

-- Within three years of the date it began providing video service under the Act, at least 25% of households with access to the provider's service are low-income households (i.e., households with an average annual income of less than $35,000).
-- Within five years of the date it began providing service under the Act and from that point forward, at least 30% of the households with access to the provider's service are low-income households.

If a provider is using telecommunication facilities to provide video services and has more than 1.0 million telecommunication access lines in Michigan, the provider must provide access to its service to at least 25% of the households in its telecommunication service area within three years of the date it began providing video service under the Act, and to at least 50% of those households within six years. A provider is not required to meet the 50% requirement until two years after at least 30% of the households with access to its service subscribe to the service for six consecutive months.

A provider may apply to the franchising entity, and, in the case of a provider with more than 1.0 million telecommunication access lines, to the PSC, for a waiver of or an extension to meet the service requirements if any of the following apply:

-- The inability to obtain access to public and private rights-of-way under reasonable terms and conditions.
-- Developments or buildings not being subject to competition because of existing exclusive service arrangements.

-- Developments and buildings being inaccessible using reasonable technical solutions under commercial reasonable terms and conditions.
-- Natural disasters.
-- Factors beyond the provider's control.

A provider may not be required to comply with, and a franchising entity may not impose or enforce, any mandatory build-out or deployment provisions, schedules, or requirements except as required by the Act.

Dispute Resolution Process. Each provider must establish a dispute resolution process for its customers. Additionally, by June 1, 2007, the PSC must submit to the Legislature a proposed process to be added to the Act that would allow the Commission to review disputes that are not resolved under the customer dispute resolution process, as well as disputes between a provider and a franchising entity and disputes between providers.

Violations & Penalties. After notice and hearing, if the PSC finds that a person has violated the Act, it must order remedies and penalties to protect and make whole anyone who has suffered damages as a result of the violation. The PSC may do one or more of the following:

-- Except as provided below, order the person to pay a fine of not less than $1,000 or more than $20,000 for a first offense, or at least $2,000 but not more than $40,000 for a subsequent offense.
-- If the provider has fewer than 250,000 telecommunication access lines in Michigan, order the person to pay a fine of not less than $200 or more than $500 for a first offense, or at least $500 but not more than $1,000 for a second or subsequent offense.
-- Revoke a uniform video service local franchise.
-- Issue cease and desist orders.

Arguments Supporting & Opposing the Legislation

According to proponents of the Act, in creating one set of rules by which all providers must abide, the Act eliminates the need for cable providers to negotiate separate contracts with hundreds of local units and will facilitate an earlier entry to the market by new competitors. The increased competition, in turn, should help drive down prices and encourage technological innovation and the deployment of new services. Additionally, according to supporters, the Act will result in the creation of thousands of new jobs and the investment of millions of dollars in Michigan.

Local units of government are concerned that the Act permits an incumbent cable provider to break its existing franchise agreement and choose to operate under the new, uniform agreement. The municipalities argue that existing agreements were negotiated in good faith, and that local units and consumers are relying on the original terms for the duration of the contract. If an incumbent provider may break its contract, municipalities could lose valuable in-kind services or simply be left without service. Incumbent providers, however, claim that they need the ability to abrogate their current contracts so that incoming competitors do not have an unfair advantage under the terms of the uniform agreement.

Local governments also are concerned that a statewide franchise system will not be as responsive as the locally based system is to customer questions and complaints. Additionally, local units are troubled that the legislation allows a provider to obtain an extension for compliance with, or a waiver from, the prescribed build-out requirements. They worry that providers might target their service only to the most profitable customers, negating the benefits that increased competition is supposed to bring. Opponents of the legislation also point out that there was nothing under the local franchise system prohibiting new providers from entering the market.

Net Neutrality

A point of contention in discussions about the legislation was the issue of net neutrality, a concept some people assert is critical to maintaining free speech and an open internet. Advocates of net neutrality protections believe that the statute should contain provisions that would prevent large cable and internet providers from interfering with access to the websites of their competitors, or creating a tiered system by charging website owners exorbitant fees to provide site visitors with a better connection.

Those who oppose including net neutrality provisions in State law argue that they are unnecessary absent a significant documented history of providers' engaging in such activities. These parties also assert that Federal law supersedes state law, and, since the Federal Telecommunications Act does not include net neutrality provisions, the State is precluded from enacting them. Some net neutrality advocates have claimed that a net neutrality requirement would fall within the realm of consumer protection measures, which the Federal law does grant states the right to enact. Since the Federal statute does not specifically address net neutrality, however, there is ambiguity regarding the State's authority over the matter. Additionally, some contend that, if net neutrality requirements are to be enacted, they should be enacted at the Federal level, rather than the state level, because the internet is not limited by state boundaries.

The recently enacted legislation does not include net neutrality provisions, but the Governor has urged the Legislature to address the issue. Thus, it is possible that the subject will be revisited in the 2007-2008 session.

State Notes

TOPICS OF LEGISLATIVE INTEREST

November/December 2006

Road and Bridge Construction Financing
By Debra Hollon, Fiscal Analyst

The financing of road and bridge construction is a multifaceted issue. As discussed in this article, factors include not only revenue levels and the costs of materials but the timing of projects and the availability of Federal funds, as well. Each factor must be considered as a part of the whole.

Revenue

Over 95.0% of the revenue credited to the Michigan Transportation Fund (MTF) comes from motor fuel taxes and vehicle registration fees. The current Michigan motor fuel tax rates are 19 cents per gallon for gasoline and 15 cents per gallon for diesel fuel. (Comparison information concerning the fuel tax rates of other states can be found on the Senate Fiscal Agency (SFA) website.) Vehicle registration fees are based upon the value of the vehicle.

Unlike the sales tax, which is a percentage of the dollar amount sold, the motor fuel tax rate is a fixed amount per gallon. As a result, an increase in the price per-gallon of fuel does not increase revenue to the MTF. In fact, as the per gallon price rises, consumer usage often decreases, which results in a decrease in State revenue from this source. One example of this effect can be seen after the surge in fuel prices following Hurricanes Katrina and Rita in 2005. Gasoline and diesel motor fuel tax revenue to the MTF dropped by over $20.0 million from fiscal year (FY) 2004-05 to FY 2005-06. Revenue from this funding source in FY 2005-06 was essentially the same as that collected in FY 2001-02.

Revenue from vehicle registration fees has increased slightly over that collected five years ago. This trend may not continue, however. As noted above, vehicle registration fees are based upon the value of the vehicle. As consumers shift from more expensive, less fuel-efficient vehicles (such as SUVs) to smaller vehicles that have greater fuel efficiency, revenue from this funding source also will decrease.

Total revenue to the Fund was at virtually the same level in FY 2005-06 as it was in FY 2001-02. Not only has the level of revenue remained relatively constant, the purchasing power of that revenue has decreased. According to data compiled by the SFA, the inflation-adjusted value of gasoline tax revenue (which makes up the vast majority of fuel tax revenue) dropped 19.1% from FY 1998-99 to FY 2005-06.

Not all revenue to the Michigan Transportation Fund can be used for road and bridge construction. Various statutory requirements disburse funds to areas such as rail grade crossings, public transit operations, and economic development transportation projects. After these statutory disbursements are made, 39.1% of the remainder is routed to the State Trunkline Fund for road and bridge construction. Because the revenue to the State Trunkline Fund is a percentage of the balance of the MTF, it also has remained relatively flat over the past several years. An additional $43.0 million is statutorily designated for debt service for projects financed through bond proceeds. Revenue to the State Trunkline Fund also includes Federal funds, which must be spent for specific uses, including debt service. The amounts received from the Federal government have fluctuated over the past five fiscal years.

Construction Expenditures

While revenue for the MTF is at virtually the same level as it was five years ago, the costs of construction have increased over the same time frame. According to the U.S. Department of Labor, Bureau of Labor Statistics' Producer Price Index, overall prices for highway and street construction have increased by 21.8% from 2001 through 2005. Final figures for 2006 are not available at this time, but the upward trend continued through October 2006.

Three major contributors to this increase are the prices for iron and steel scrap, cement, and asphalt paving mixtures. Prices increased for iron and steel scrap by 141.5% and for cement by 17.4% over the same five calendar years. The Bureau of Labor Statistics did not begin tracking asphalt paving mixtures prices until December 2003. From that point until December 2005, the prices for this category increased 10.7%. The preliminary figures through October 2006, however, show an increase of 51.7% over December 2003. It should be noted that asphalt prices are directly related to oil prices.

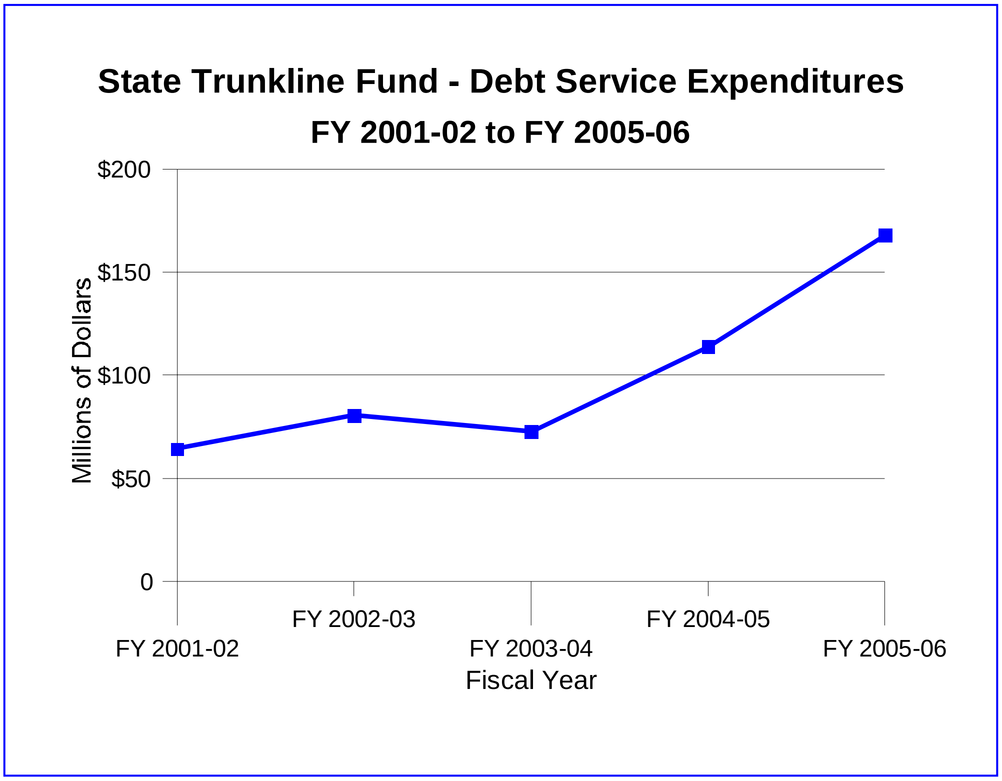
In addition to the rise in the prices of construction components, expenditures also have increased as projects have been accelerated. The Jobs Today program was implemented in 2005 and covered many aspects of State government in an effort to create jobs and stimulate the economy. As it relates to transportation, the program accelerates the timing of over 150 projects over two years. In addition, legislation enacted in 2006 created the Local Jobs Today program to provide increased loans and grants to local units of government to enable them to obtain Federal funding for transportation projects.

Bond Financing

As a result of static revenue and rising costs, the Michigan Department of Transportation (MDOT) has incurred increasing levels of debt over the past several years. According to MDOT, it has incurred approximately $1.3 billion in new debt since FY 2000-01. Of this amount, $600.0 million is for the Build Michigan II program and $308.2 million is for Build Michigan III.

As noted above, $43.0 million is statutorily designated to the State Trunkline Fund for debt service. Additional amounts are used for debt service as required. Because the revenue remains relatively flat, as the amount used for debt service increases, the amount left to fund construction projects decreases. Figure 1 reflects debt service obligations from the State Trunkline Fund over the past five years.

Figure 1



An increase in the level of indebtedness is not a phenomenon limited only to Michigan. According to data on state obligations for highways compiled by the US Department of Transportation, Federal Highway Administration, Office of Highway Policy Information[1], Michigan's obligations increased by 36.8% from 2001 to 2005. The national average increased by 33.1% over the same period. Of the surrounding states, increases were seen by Illinois (68.2%), Ohio (5.1%), and Wisconsin (65.8%). Only Indiana showed a decrease over the five-year period (32.4%).

The Michigan Department of Transportation expects this trend for Michigan to continue at least in the near future. The Department plans to issue $315.0 million in Grant Anticipation Revenue Vehicle (GARVEE) bonds both in 2007 and in 2009. Even with this additional funding, the 2007-2011 Five-Year Highway Program notes a funding gap in the capital program (including routine maintenance) of $129.0 million over the five years. At this time, MDOT anticipates debt service obligations to peak in FY 2009-10.

[1] Data used to facilitate state-to-state comparisons might not match other figures in this document.